Presenting Today

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Agenda

- Fraud and Internal Control Definitions/Factors
- Results of 2012 ACFE Report
- Misappropriation of Assets
  - Types/Examples
  - What to Watch For
- Red Flags of Potential Fraud
- Relevant Fraud Cases
Fraud Defined

“A deception deliberately practiced in order to secure unfair or unlawful gain” (Webster’s English Dictionary)

We will focus on one key type of fraud: Misappropriation

- “Misstatements arising from misappropriation of assets involving the theft of an organization's assets”
Fraud Factors

Incentive / Pressure

Rationalization

Opportunity

McGladrey
“Internal Control” means different things to different people

Authoritative guidance from COSO defines Internal Control* as a process designed to provide reasonable assurance regarding the achievement of business objectives

Internal control has three main objectives:
- To promote effectiveness and efficiency of operations
- To ensure reliability of financial reporting
- To maintain compliance with applicable laws and regulations

* Internal Control – Integrated Framework, Committee of Sponsoring Organizations (“COSO”) of the Treadway Commission
Benefits of Internal Controls

**Financial Reporting**
- Promotes integrity of data used in making business decisions
- Assists in fraud prevention and detection through the creation of an auditable trail of evidence

**Operations**
- Promotes efficiency and effectiveness of operations through standardized processes
- Ensures the safeguarding of assets through control activities

**Laws and Regs**
- Helps maintain compliance with laws and regulations through periodic monitoring
Government Fraud Trends:
Association of Certified Fraud Examiner’s (ACFE) – 2012
Report to the Nations on Occupational Fraud and Abuse

- Based on the examination of 1,388 occupational fraud cases that were investigated between January 2010 and December 2011 by Certified Fraud Examiners
- “Occupational fraud” is defined within the report as:
  - “The use of one’s occupation for personal enrichment through the deliberate misuse or misapplication of the employing organization’s resources or assets”
- Key Overall Findings:
  - Typical organization loses an estimated 5% of its annual revenue to occupational fraud
  - Median loss from occupational fraud was $140,000
Where Do You Think Governments Rank In Terms Of Being A Victim Of Fraud?
Victim Organizations

Organization Type of Victim — Frequency

<table>
<thead>
<tr>
<th>Type of Victim Organization</th>
<th>2012</th>
<th>2010</th>
<th>2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>Private Company</td>
<td>39.3%</td>
<td>42.1%</td>
<td>39.1%</td>
</tr>
<tr>
<td>Public Company</td>
<td>28.0%</td>
<td>32.1%</td>
<td>28.4%</td>
</tr>
<tr>
<td>Government</td>
<td>16.8%</td>
<td>16.3%</td>
<td>18.1%</td>
</tr>
<tr>
<td>Not-for-Profit</td>
<td>10.4%</td>
<td>9.6%</td>
<td>14.3%</td>
</tr>
<tr>
<td>Other*</td>
<td>5.5%</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Where Do You Think Governments Rank In Terms Of Median Losses Per Occupational Fraud?
Victim Organizations

Organization Type of Victim — Median Loss

- Private Company: $200,000 in 2012, $231,000 in 2010, $278,000 in 2008
- Public Company: $127,000 in 2012, $142,000 in 2008
- Not-for-Profit: $100,000 in 2012, $90,000 in 2010, $109,000 in 2008
- Government: $81,000 in 2012, $100,000 in 2010, $100,000 in 2008
- Other*: $75,000 in 2012
What Is The Most Common Type Of Occupational Fraud Committed?
How Occupational Fraud is Committed

Occupational Fraud by Category — Frequency

<table>
<thead>
<tr>
<th>Type of Fraud</th>
<th>2012</th>
<th>2010</th>
<th>2008</th>
</tr>
</thead>
<tbody>
<tr>
<td>Asset Misappropriation</td>
<td>86.7%</td>
<td>86.3%</td>
<td>88.7%</td>
</tr>
<tr>
<td>Corruption</td>
<td>33.4%</td>
<td>32.8%</td>
<td>26.9%</td>
</tr>
<tr>
<td>Financial Statement Fraud</td>
<td>7.6%</td>
<td>4.8%</td>
<td>10.3%</td>
</tr>
</tbody>
</table>
What Are The Top 3-5 Most Prevalent Fraud Schemes Perpetrated on Governments?
## Victim Organizations

### Government and Public Administration

**141 Cases**

<table>
<thead>
<tr>
<th>Scheme</th>
<th>Number of Cases</th>
<th>Percent of Cases</th>
</tr>
</thead>
<tbody>
<tr>
<td>Corruption</td>
<td>50</td>
<td>35.5%</td>
</tr>
<tr>
<td>Billing</td>
<td>33</td>
<td>23.4%</td>
</tr>
<tr>
<td>Non-Cash</td>
<td>27</td>
<td>19.1%</td>
</tr>
<tr>
<td>Skimming</td>
<td>25</td>
<td>17.7%</td>
</tr>
<tr>
<td>Expense Reimbursements</td>
<td>19</td>
<td>13.5%</td>
</tr>
<tr>
<td>Payroll</td>
<td>18</td>
<td>12.8%</td>
</tr>
<tr>
<td>Check Tampering</td>
<td>15</td>
<td>10.6%</td>
</tr>
<tr>
<td>Cash on Hand</td>
<td>12</td>
<td>8.5%</td>
</tr>
<tr>
<td>Cash Larceny</td>
<td>10</td>
<td>7.1%</td>
</tr>
<tr>
<td>Financial Statement Fraud</td>
<td>9</td>
<td>6.4%</td>
</tr>
<tr>
<td>Register Disbursements</td>
<td>4</td>
<td>2.8%</td>
</tr>
</tbody>
</table>
Understanding Embezzlement and Its Forms

- Most popular financial crime
- Defined as a person in rightful control of real or personal property who makes unlawful use of that property without the owner’s permission or consent
- Being aware of common fraud schemes and key controls to have in place reduces risk of fraud losses

- Forms of embezzlement:
  - Skimming
  - Cash larceny
  - Billing (Purchasing)
  - Payroll

- Decentralized operations increase embezzlement risks
Skimming Examples

- Removal of cash from an entity prior to its entry into an accounting system
- Money is stolen before it is recorded
- No direct audit trail—stolen funds are never recorded as the institution is unaware that the cash was ever received

Controls to prevent skimming:

- Appropriate segregation of duties and access control procedures regarding who makes general ledger transactions
- Proper controls and documentation for cash intake at bursar/business office window (student registration and fees)
Cash Larceny Examples

- Intentional taking of employer’s cash which can include currency or checks without the consent or against the will of the employer

Controls to prevent cash larceny:
- Daily cash balancing/reconciliations
- Accountability for cash drawer overages/shortages and consequences if differences continue
- Assignment rotation and mandatory vacations
- Surprise cash counts
Billing/Purchasing Scheme Examples

- Misappropriating funds without ever handling cash
- Making false claims for payment on behalf of the institution
- Personal purchases made with institution’s funds

Controls to prevent purchasing fraud:
- Authorization procedures of purchase orders, invoicing and payments should be documented and adhered to
- Approved vendor listing and monitoring of changes to this list
- Proper documentation and approvals
- Segregation of duties among authorization, purchasing, receiving, shipping and accounting
Payroll Examples

- Falsification of a time card or altered information in payroll records
- Ghost employee, falsified hours, and salary and commission schemes
- Submitting fake or falsified expense reports

Controls to prevent payroll fraud:
- Review and analysis of expense accounts—historical comparisons and comparisons with budgets
- Detail review of expense reimbursements
- Segregation of duties in payroll preparation, distribution, bank reconciliations and Human Resources functions
- Regular review, analysis, and documented sign-off on payroll activity
What Do You Think Are The Top 3-5 Weaknesses Identified As Key Contributing Factors to Fraud?
Victim Organizations

Primary Internal Control Weakness Observed by CFEs

<table>
<thead>
<tr>
<th>Most Important Contributing Factor</th>
<th>Percent of Cases 2012</th>
<th>Percent of Cases 2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Lack of Internal Controls</td>
<td>35.5%</td>
<td>37.8%</td>
</tr>
<tr>
<td>Override of Existing Internal Controls</td>
<td>19.4%</td>
<td>19.2%</td>
</tr>
<tr>
<td>Lack of Management Review</td>
<td>18.7%</td>
<td>17.9%</td>
</tr>
<tr>
<td>Poor Tone at the Top</td>
<td>9.1%</td>
<td>8.4%</td>
</tr>
<tr>
<td>Lack of Competent Personnel in Oversight Roles</td>
<td>7.3%</td>
<td>6.9%</td>
</tr>
<tr>
<td>Lack of Independent Checks/Audits</td>
<td>5.6%</td>
<td>3.3%</td>
</tr>
<tr>
<td>Lack of Employee Fraud Education</td>
<td>2.5%</td>
<td>1.9%</td>
</tr>
<tr>
<td>Other*</td>
<td>2.2%</td>
<td>1.8%</td>
</tr>
<tr>
<td>Lack of Clear Lines of Authority</td>
<td>1.8%</td>
<td>1.8%</td>
</tr>
<tr>
<td>Lack of Reporting Mechanism</td>
<td>0.3%</td>
<td>0.6%</td>
</tr>
</tbody>
</table>
Fraud Red Flags – How to Use Them Effectively

- Don’t take a “guilty until proven innocent” approach; instead:
  - Exercise healthy skepticism
  - Periodically assess your organization for signs
- Use them as an opportunity to strengthen your institution and reduce your fraud risk by recommending new or enhanced internal controls
Perpetrator Red Flags

Behavioral Red Flags of Perpetrators

- Living Beyond Means
- Financial Difficulties
- Unusually Close Association with Vendor/Customer
- Control Issues, Unwillingness to Share Duties
- Divorce/Family Problems
- Wheeler-Dealer Attitude
- Irritability, Suspiciousness or Defensiveness
- Addiction Problems
- Past Employment-Related Problems
- Complained About Inadequate Pay
- Refusal to Take Vacations
- Excessive Pressure from Within Organization
- Past Legal Problems
- Complained About Lack of Authority
- Excessive Family/Peer Pressure for Success
- Instability in Life Circumstances

Percent of Cases
Relevant Examples of Fraud

- **Case #1 – Purchasing Fraud**
  - Director of Finance at a government client took advantage of a large capital project ongoing by creating false invoices for construction and including them in the list of payments for Board to approve.
  - Lack of segregation of duties, combined with lack of detailed bill approval by Board, lead to this fraud.

- **Case #2 – Credit Card Fraud**
  - Program supervisor at a NFP organization had credit card for emergency purchases needing to be made for program. Supervisor used the credit card at Jewel to purchase gift cards for personal use.
  - Lack of review of credit card statements for employees lead to this fraud.
Relevant Examples of Fraud

- Case #3 – Purchasing Fraud by User Department
  - IT Director given authority to handle purchasing responsibilities for department with limited oversight.
  - Purchased items which were properly approved and expensed, however items were never placed in service. Goods were resold by employee.
  - Lack of segregation of duties, combined with management’s limited understanding of the IT department and its spending needs, contributed to the fraud.
Questiions
THANK YOU

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